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IN THE

# Supreme Court of the United States

**October Term, 1987**

WYOMING COMMUNITY DEVELOPMENT AUTHORITY, FIRST INTERSTATE BANK OF CASPER, N.A., and CITIBANK, N.A.,

*Petitioners,*

v.

MARVIN B. DURNING and JEAN C. DURNING, husband and wife, on behalf of themselves and all other persons similarly situated,

*Respondents.*

## ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

## RESPONDENTS' BRIEF IN OPPOSITION

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## RESPONDENTS' BRIEF IN OPPOSITION

The respondents Marvin B. Durning and Jean C. Durning, on behalf of themselves and all other persons similarly situated, respectfully request that this Court deny the petition for certiorari seeking review of the decision of the United States Court of Appeals for the Ninth Circuit. That opinion is reported at 815 F.2d 1265.

## STATEMENT OF THE CASE

In 1981, defendant Wyoming Community Development Authority ("the Authority") sold mortgage revenue bonds ("the Bonds") to a group of underwriters for distribution to the public (ER 30).[1]

Plaintiffs Marvin B. Durning and Jean C. Durning bought four Bonds in the principal amount of $5,000 each through their broker, Shearson/American Express ("Shearson") (ER 81).

An Official Statement (ER 30-73), a disclosure document equivalent to a prospectus, indicated that the Bonds could not be "called" (redeemed by the issuer prior to their maturity date) until at least 1991. By contrast, official statements for previous and subsequent bond issues of the Authority stated explicitly that those bond issues could be redeemed "at any time" (ER 78-80), but that statement had been deleted from the Official Statement for the Durnings' Bonds.

The Durnings and sophisticated members of the financial bond marketing community read the Official Statement to mean that the Bonds were not subject to redemption prior to 1991. MOODY'S MUNICIPAL & GOVERNMENT MANUAL, the leading source book on municipal bonds, described the Bonds as not callable before June 1, 1991. (ER 79.) The purchase confirmation record that the Durnings received from Shearson stated that the Bonds were "Callable 06/01/91." (ER 81.)

The Official Statement did not accurately disclose the terms of the Trust Indenture, which did in fact permit redemption in whole at any time or in part on any date on which interest is payable.

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[1] Citations denominated "ER" are to plaintiffs' complaint and attached exhibits in the Excerpts of Record on appeal to the Ninth Circuit.

In two redemptions in 1983 and 1985, the Authority redeemed a total of nearly $32 million of the Bonds. (ER 3.) One of the Durnings' Bonds was called in the 1985 redemption. (ER 18.) Coincidental with the 1985 redemption, the price of the Bonds in the secondary market dropped sharply. (ER 17-18.)

The Durnings filed a class action charging that the Official Statement did not inform investors the Bonds were redeemable prior to 1991. Plaintiffs attached as exhibits to their complaint the Official Statement, excerpts from MOODY'S MUNICIPAL & GOVERNMENT MANUAL, the purchase confirmation statement from Shearson, and the "sale" confirmation statement showing redemption of one of the Durnings' Bonds (ER 30 to 84).

The district court dismissed the complaint for failure to state a claim. *Durning v. The First Boston Corp.*, 627 F. Supp. 393 (W.D. Wash. 1986). The court held: (1) as a matter of law the Official Statement unambiguously disclosed that the Bonds could be redeemed prior to 1991, and (2) neither the Moody's or Shearson exhibits nor the Authority's treatment of similar redemption provisions in other issues were relevant to whether the Official Statement was misleading. (Pet. C-11-13.)

The Ninth Circuit reversed. *Durning v. The First Boston Corp.*, 815 F.2d 1265 (9th Cir. 1987). Applying the objective "reasonable investor" test, the Court of Appeals reviewed both ambiguous language in the Official Statement and the documents attached to the complaint indicating that even professional bond analysts and traders in the market had been misled by the Official Statement. The Court concluded:

> In reviewing the complaint and the Official Statement, we cannot conclude, as did the district court, that "reasonable minds cannot differ," *TSC Industries*, 426 U.S. at 450, as to whether a reasonable investor in reading

> this Official Statement would conclude that the bonds were callable prior to June 1, 1991. We hold that the Durnings have stated a claim under federal securities laws and that the trial court erred in deciding that the Official Statement was unambiguous as a matter of law.

(Pet. A-23-24.)

## REASONS WHY THE WRIT SHOULD BE DENIED

### 1. The Ninth Circuit's Decision Is Not In Conflict With Decisions of Other Circuits.

Petitioners concede that the Ninth Circuit Court of Appeals correctly adopted the objective "reasonable investor" standard for determining whether the Official Statement contained an adequate disclosure of the callability of the Bonds. (Pet. 12, 16.) Petitioners also concede that the legal standard relied upon by the Ninth Circuit is not in conflict with the decisions of other circuits.

Petitioners' only quarrel is with the Court of Appeals' application of that standard to the facts contained in the complaint and attached exhibits. The Ninth Circuit concluded that reasonable minds could differ on the question whether a reasonable investor would be misled by the Official Statement. Defendants disagree. That is not a ground for grant of certiorari under Supreme Court Rule 17.1(a).

#### *a. The Court of Appeals Explicitly Adopted And Applied An Objective "Reasonable Investor" Standard.*

Petitioners agree that the Court of Appeals correctly adopted an objective "reasonable investor" test for determining whether the Official Statement was misleading. (Pet. 3, 12, 16.) Petitioners argue that one sentence of the opinion indicates that the Court actually applied a subjective standard instead, because it referred to whether a reasonable investor "might" (rather than "would") be misled. (Pet. 12, 16.) The

contention is sheer fantasy and seriously mischaracterizes the Court's opinion.

The Court of Appeals repeatedly emphasized the necessity of an objective "reasonable investor" standard. The Court stated:

> To determine whether the Official Statement was misleading, we apply the "reasonable investor" test: whether an investor who had been reasonably diligent in reviewing the Official Statement *would* have been mislead [sic] as to the callability of the Bonds. *See Admiralty Fund v. Hugh Johnson & Co.*, 677 F.2d 1301, 1306 (9th Cir. 1982). *This is an objective test. Id.*

(Pet. A-14 (emphasis added).) The Court explained that it had adopted the same objective test to determine whether a fact is "material" because of the need for objective standards in both contexts:

> The application of the reasonable investor test is appropriate because adequacy of disclosure, like materiality, *only can be judged against an objective standard of investor behavior.*

(Pet. A-14-15 n.4 (emphasis added).)

The Court of Appeals then analyzed the application of that standard in the specific context of petitioners' Rule 12(b)(6) motion.

> Whether an Official Statement adequately discloses callability is a mixed question of law and fact. *Cf. TSC Industries*, 426 U.S. at 450. "The determination requires delicate assessments of the inferences a 'reasonable shareholder' *would* draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact." *Id.* Only if the disclosure is so obvious that reasonable minds cannot differ is the issue appropriately resolved as a matter of law. *Id.* Like materiality, adequacy of dis-

> closure is normally a jury question. *Admiralty Fund*, 677 F.2d at 1306.

(Pet. A-15-16. (Emphasis added.) The Court used the word "might" only in framing the resulting two-level inquiry (1) whether reasonable minds could differ as to (2) whether a reasonable investor would be misled as to the callability of the Bonds:

> A jury could conclude that a reasonable investor might fail to understand that the bonds are redeemable under this section whenever funds in the Account are sufficient.

(Pet. A-20.) The entire petition thus is falsely premised on a single word, taken wholly out of context, in the Court of Appeals' application of the concededly correct objective standard. Petitioners' contention that the Court of Appeals surreptitiously applied a "subjective" test instead is simply a sham.

### *b. The Court of Appeals Endorsed the Fifth Circuit's Decision in* Associated Builders *And Distinguished The Decision On Its Facts.*

Petitioners contend the decision of the Court of Appeals is in conflict with the decision of the Fifth Circuit Court of Appeals in *Associated Builders, Inc. v. Alabama Power Company*, 505 F.2d 97 (5th Cir. 1974). (Pet. 20-21.) In that case the court, applying the same "reasonable investor" standard, found as a matter of law that a prospectus had adequately disclosed the mandatory redemption feature of certain bonds, and affirmed a dismissal of the complaint. 505 F.2d at 101-102.

In a crude effort to manufacture a conflict between the decisions of the Ninth and Fifth Circuits, petitioners simply omitted any reference to the Ninth Circuit's careful analysis of the *Associated Builders* decision. The Ninth Circuit sum-

marized the Fifth Circuit's decision, implicitly endorsed its holding, and determined that the facts of this case compelled a different result. (Pet. A-21-23.)

In distinguishing *Associated Builders*, the Ninth Circuit gave particular weight to the documents other than the Official Statement which were attached to the Durnings' complaint and which showed that even professional bond analysts had in fact been misled as to the callability of the Bonds. The Court of Appeals summarized the factual differences as follows:

> *Associated Builders* is distinguishable from this case. The central issue in both cases, whether the Statements adequately informed the investor of callability, is a fact specific inquiry, and the prospectus in *Associated Builders* differs significantly from the Official Statement at issue in this case. In *Associated Builders*, portions of the prospectus expressly notified the investor that the bonds were callable "at any time on 30 days' notice." There were no allegations of confusion on the part of experts comparable to the Moody's rating and Shearson American Express confirmation statements plaintiffs submitted in this case. The case at bar is not a case where the issue of adequate disclosure could be determined by a trial court as a matter of law.
>
> In reviewing the complaint and the Official Statement, we cannot conclude, as did the district court, that "reasonable minds cannot differ," *TSC Industries*, 426 U.S. at 450, as to whether a reasonable investor in reading this Official Statement would conclude that the bonds were callable prior to June 1, 1991.

(Pet. A-22-23.)[2]

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[2] The Court of Appeals could also justifiably have relied on the Durnings' allegation of a sharp drop in the Bonds' value on the secondary market after the redemption, indicating that a substantial number of the persons and institutions comprising the market were similarly misled as to the redemption provisions.

*(see next page)*

There is no indication that the Fifth Circuit would reach any different result on these facts than the Ninth Circuit did. The asserted "conflict" between these circuits, arising solely from the courts' application of the same rule of law to different factual situations, is not a basis for certiorari. *See United States v. Johnston*, 268 U.S. 220, 227 (1925) ("We do not grant a certiorari to review evidence and discuss specific facts").

***c. The Ninth Circuit Correctly Refused To Hold As A Matter Of Law That The Official Statement Adequately Disclosed Callability.***

Petitioners apparently contend that a proper application of the objective "reasonable investor" test to plaintiffs' complaint required the Court of Appeals to hold as a matter of law that the Official Statement adequately disclosed the callability of the Bonds. Petitioners theorize that any reasonable investor would have known that the Authority needed to provide for extraordinary redemption in the event there is little demand for mortgage money or the mortgagees prepay their loans. (*See* Pet. 5-6.) For example, petitioners state that the district court "considered all of the terms of the Official Statement, *as well as the practical operation of a housing revenue bond program.*" (Pet. 21.) (Emphasis added.) Petitioners contend the Court of Appeals' "reading is unreasonable *in the context of this program.*" (Pet. 22 n.25.) (Emphasis added.) "If, however, a court were permitted to review plaintiffs' allegations and draw reasonable inferences *supported by the objective reality of the single-family mortgage revenue bond market* and the clear language of the Official Statement, plaintiffs' far-fetched reading could be dismissed as such." (Pet. 24.) (Emphasis added.) This Court should reject petitioners' contention, as did the Court of Appeals, for three reasons.

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*(continued from previous page)*

Those allegations must be taken as true in determining the sufficiency of the Durnings' complaint. *E.g., Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974). In short, no one — other than the district court — appears to share petitioners' interpretation of the Official Statement.

First, petitioners' contentions consist of nothing but the unsupported argument of counsel. (*See* Pet. 5-7.) At this interlocutory stage there is no evidence or record to support any of petitioners' factual allegations concerning the operation of housing revenue bonds or what a reasonable investor would have known about them. Petitioners' selective quotations from hornbooks are no substitute for admissible evidence concerning the specific facts of this case.

Second, even assuming a "reasonable investor" would know that issuers of housing revenue bonds often reserve the right to redeem at any time, petitioners' theory supports rather than refutes the holding of the Court of Appeals. Such an investor presumably would look for a provision in the Official Statement that the Bonds could be redeemed at any time, a provision included in the official statements for all prior and subsequent bond issues by the Authority. The investor would not find it. The investor would place a correspondingly higher value on the Bonds (as the secondary market did in this case) because of the lack of a provision for such redemption.

Third, petitioners' argument that a reasonable investor would know the Bonds were callable at any time is in direct conflict with the Durnings' allegations that professional bond analysts as well as traders in the secondary market for the Bonds were in fact misled as to the callability of the Bonds. As this Court held in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976), "These are questions we think best left to the trier of fact." 426 U.S. at 460.

**2. This Case Presents No Important Unsettled Question of Federal Law.**

Petitioners suggest the issue whether adequacy of disclosure should be tested by a "reasonable investor" standard is an "important question of federal law which has not been, but should be, decided by this Court." S. Ct. Rule 17.1(c). (Pet. 14, 15-16.)

Petitioners fail to explain why the Court should resolve that question in this case, where all the parties agree that the reasonable investor test should be applied.

Nor do the federal courts disagree. This Court has already applied the reasonable investor test to questions of materiality in *TSC Industries, supra*, and the circuits are consistent in extending that same standard to determination of the adequacy of disclosure.

### 3. The Durnings Are Entitled to An Award of Attorneys' Fees and Costs Against Petitioners' Counsel.

This Court has emphasized "the necessity for clear, definite, and complete disclosures concerning the controversy when applying for certiorari." *Southern Power Co. v. North Carolina Public Service Co.*, 263 U.S. 508, 509 (1924). The petition does not meet that standard.

The petition mischaracterizes the Court of Appeals' holding by taking isolated words out of context, falsely implies that the Court of Appeals disagreed with or did not consider the Fifth Circuit's decision in *Associated Builders*, and deceptively omits any reference to the very documents and factual allegations on which the Court of Appeals expressly relied in concluding that a reasonable jury could find the Official Statement misleading.

There is in fact no reasonable basis for a grant of certiorari, and petitioners' counsel cannot have had any serious or good faith belief that the petition was justified. The Durnings are entitled to an award of their costs and attorneys' fees incurred in responding to the petition pursuant to 28 U.S.C. § 1927.[3]

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[3] 28 U.S.C. § 1927 provides:

> Any attorney or other person admitted to conduct cases in any court of the United States or any Territory thereof who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct.

*See, e.g. Chalfy v. Turoff*, 804 F.2d 20, 23 (2d Cir. 1986) (award appropriate where appeal lacked any support in law or the record); *Jones v. Continental Corporation*, 789 F.2d 1225, 1230 (6th Cir. 1985) (fee award proper for frivolous claims or tactics that needlessly obstruct litigation).

## CONCLUSION

For the reasons stated above, the petition for certiorari should be denied with directions to the District Court to award respondents appropriate relief under 28 U.S.C. § 1927.

Respectfully submitted,

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